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No. 93-1504

IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

THE CELOTEX CORPORATION,

Petitioner,

vs.

BENNIE EDWARDS and JOANN EDWARDS,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF THE NEW YORK CLEARING HOUSE ASSOCIATION, *AMICUS CURIAE* SUPPORTING AFFIRMANCE

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This brief is in support of affirmance and is filed pursuant to Rule 37.3 with the consent of all parties.

Interest of *Amicus Curiae*

The New York Clearing House Association (the "Clearing House") is an association of 11 leading commercial banks in the City of New York.[1] The Clearing

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[1] The members of the Clearing House are The Bank of New York, The Chase Manhattan Bank, N.A., Citibank, N.A., Chemical Bank, Morgan Guaranty Trust Company of New York, Bankers Trust Company, Marine Midland Bank, N.A., United States Trust Company

(continued...)

House regularly appears as *amicus curiae* in cases raising significant questions of law relating to banking, including cases concerning the enforceability of letters of credit.[2]

The Clearing House addresses only the issue whether the supersedeas bond posted by Petitioner is property of the estate of Petitioner, a debtor in possession under the Bankruptcy Code. The Fifth Circuit held that a supersedeas bond is not property of a debtor in bankruptcy, and thus is not subject to the automatic stay of 11 U.S.C. § 362(a) or the equitable powers of the bankruptcy court under 11 U.S.C. § 105. *Edwards* v. *Armstrong World Indus., Inc.*, 6 F.3d 312, 317 (5th Cir. 1993). The Fifth Circuit recognized that efforts by bankruptcy courts to enjoin payments under letters of credit raise similar issues, and hence relied heavily on *Kellogg* v. *Blue Quail Energy, Inc.* (*In re Compton Corp.*), 831 F.2d 586, 589 (5th Cir. 1987), *modified on other grounds*, 835 F.2d 584 (1988), which held that because a letter of credit is not property of the debtor's estate, the bankruptcy court could not enjoin a payment of funds from the letter of credit to the beneficiary. The other briefs filed with the Court have not addressed this dispositive issue.

Letters of credit are essential to facilitating the national and international flow of commerce. U.S. banks have more than $200 billion of letters of credit outstanding. Ferguson & Co., *BankSource* (1994). The member banks of the Clearing House have outstanding letters of credit with an aggregate

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[1](...continued)

of New York, National Westminster Bank USA, European American Bank and Republic National Bank of New York.

[2] A letter of credit is an arrangement involving an issuer (a bank), its customer, and a third party beneficiary. For a fee paid by the customer, the bank agrees to take on primary liability to pay the beneficiary upon the occurrence or non-occurrence of a specified event (for example, the customer's default on payment or performance).

value in the tens of billions of dollars. Reversal of the decision of the Fifth Circuit could call into question existing letter of credit law and practices, and would impede the flow of commerce by undermining the reasonable expectations of the member banks, their customers and beneficiaries of letters of credit. In particular, reversal might call into question the established principles that the obligation of the issuing bank under a letter of credit is entirely separate and distinct from the transactions that resulted in the bank issuing the letter of credit, that a letter of credit is an obligation only of the issuing bank and not property of the estate, and that the integrity and independence of letters of credit must be protected, not nullified, by the courts if letters of credit are to serve their essential function.

ARGUMENT

I.

The Supersedeas Bond Is Not Property Of Petitioner's Estate Subject To The Automatic Stay Or The Section 105 Injunction Because Petitioner Retains No Interest In It.

Courts have long recognized that a supersedeas bond is not an asset of the debtor's estate under the bankruptcy laws, particularly if the debtor retains no interest or even an attenuated interest in it. *See, e.g., Mid-Jersey Nat. Bank* v. *Fidelity-Mortgage Investors*, 518 F.2d 640, 643 (3d Cir. 1975) (funds deposited with court as supersedeas bond are considered *res* of a trust and court is charged with determining beneficiaries); *Saper* v. *West*, 263 F.2d 422, 427 (2d Cir. 1959), *cert. denied*, 360 U.S. 916 (1959); *Carter Baron Drilling* v. *Excell Energy Corp.*, 76 B.R. 172, 174 (D. Colo. 1987) (debtor has at most a contingent reversionary interest in its supersedeas bond and therefore

bond is not property of estate); *Moran* v. *Johns-Manville Sales Corp.*, 28 B.R. 376, 377 (D.C. Ohio 1983).

This reasoning applies with particular force where, as here, the beneficiary of the bond has already had its victory at trial affirmed on appeal, thereby divesting the debtor of even a contingent interest in its bond.[3] As the court in *Carter Baron* observed, "any contingent reversionary interest [the debtor] had in the funds terminated . . . when the . . . Court of Appeals affirmed . . . ." 76 B.R. at 174.

The court below recognized the dispositive effect of the end of the appeal process. *Edwards*, 6 F.3d at 317. It then went on to base its decision in large part on the similarities it identified between supersedeas bonds and letters of credit. *Id.* ("The promise of [a] bank to pay on a letter of credit is indistinguishable from Northbrook's promise to act as surety on the supersedeas bond."). A number of other courts have likewise found a strong resemblance between the two instruments. *See, e.g., Ligurotis* v. *Whyte*, 951 F.2d 818, 821 (7th Cir. 1992) (" . . . a letter of credit may serve as the equivalent of a supersedeas bond"); *Trans World Airlines, Inc.* v. *Hughes*, 515 F.2d 173, 177 (2d Cir. 1975) (treating supersedeas bond and letter of credit as interchangeable), *cert. denied*, 424 U.S. 934 (1976); *Southmark Corp.* v. *Riddle* (*In re Southmark Corp.*), 138 B.R. 820, 828 (Bankr. N.D. Tex. 1992) (secured supersedeas bond closely resembles secured letter of credit).

According to these courts, letters of credit and supersedeas bonds are most alike in their insulation of the obligations of the issuer and surety from the actions of the debtor. *In re Southmark*, 138 B.R. at 828. It is essential to

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[3] Although a few courts have stated that the debtor retains an interest in its supersedeas bond during the pendency of the appeal, *see, e.g. Sheldon* v. *Munford, Inc.*, 902 F.2d 7, 8 (7th Cir. 1990), this issue is wholly irrelevant here because the appeal has been decided.

both instruments that the issuing entity is obligated to pay the beneficiary upon proper demand, without regard to the ability of the debtor itself to pay. *Id.* In both cases, therefore, the issuer's "independent obligation to the beneficiary protects the beneficiary as a creditor of the grantor." *Id.*

In other words, the letter of credit is valuable precisely because *the debtor is not obligated to make the payment*. The supersedeas bond, intended as a protection against the insolvency or other inability to pay of a judgment debtor, is valuable for exactly the same reason: it guarantees payment regardless of what happens to the debtor. *Blue Quail*, 831 F.2d at 590. *See also Federal Prescription Serv., Inc.* v. *American Pharmaceutical Ass'n*, 636 F.2d 755, 760 (D.C.Cir. 1980) (bond secures appellee from loss during pending appeal); *Mid-Jersey*, 518 F.2d at 644 (purpose of deposit placed with court in lieu of supersedeas bond is to protect party prevailing at trial from possible insolvency of loser).

For these reasons, doctrines that have evolved to protect the integrity and independence of the letter of credit should also protect the supersedeas bond with equal force. Because the Bankruptcy Code does not give bankruptcy courts authority over assets that are not property of the debtor's estate, letters of credit are almost universally found immune from bankruptcy stays and injunctions. *See, e.g., First Fidelity Bank* v. *Prime Motor Inns, Inc.* (*In re Prime Motor Inns, Inc.*), 130 B.R. 610, 613 (S.D. Fla. 1991) (letter of credit is separate contract between issuer and beneficiary); *Security Servs., Inc.* v. *National Union Fire Ins. Co.* (*In re Security Servs., Inc.*), 132 B.R. 411, 414 (Bankr. W.D. Mo. 1991) (bank issuing letter of credit has obligation independent of customer's) (dictum); *Braucher* v. *Continental Ill. Nat. Bank & Trust Co.* (*In re Illinois-California Express, Inc.*), 50 B.R. 232, 234 (Bankr. D.

Colo. 1985) (letter of credit not part of debtor's estate); *Printing Dep't, Inc.* v. *Xerox Corp.* (*In re Printing Dep't, Inc.*), 20 B.R. 677, 680 (Bankr. E.D. Va. 1981) (issuer of letter of credit assumes primary obligation); *Page* v. *First Nat. Bank* (*In re Page*), 18 B.R. 713, 715 (D.D.C. 1982) (same).[4] The Clearing House respectfully requests that the Court afford the same protection to supersedeas bonds.

II.

Reversal Of The Decision Below Would Call Into Question The Stability Of Vast Numbers Of Existing Commercial And Financial Transactions.

A. Letters of Credit are Essential to a Wide Variety of Transactions.

Traditionally, letters of credit were used as a payment mechanism in connection with the sale of goods between geographically distant parties. Because the issuing bank's credit effectively replaced that of the distant purchaser, the seller was assured of payment and was thus more willing to do business with the buyer. As explained by the New York Court of Appeals,

> "Letters of credit provide a quick, economic and predictable means of financing transactions for parties not willing to deal on open accounts by permitting the seller to rely not only on the credit of the buyer but also on that of the issuing bank. By its terms, the credit often reflects a conscious negotiation of

[4] The few cases to the contrary, *see, e.g. Twist Cap, Inc.* v. *Southeast Bank* (*In re Twist Cap, Inc.*), 1 B.R. 284 (Bankr. D.Fla. 1979), have been "roundly criticized and otherwise ignored." *Blue Quail*, 138 B.R. at 589-90.

> risk allocation between customer and beneficiary and its utility rests heavily on strict adherence to the agreed terms and the doctrine of independent contract. It is this predictability of credit arrangements which permits not only the financing of sale of goods transactions between widely separated parties in different jurisdictions but also has permitted the development of a market in trade or bankers' acceptances of time drafts."

First Commercial Bank v. *Gotham Originals, Inc.*, 64 N.Y.2d 287, 297-98, 486 N.Y.S.2d 715, 721 (1985) (citation omitted); *see also, e.g., Exxon Co.* v. *Banque de Paris et des Pay-Bas*, 828 F.2d 1121, 1124 (5th Cir. 1987) ("Letters of credit facilitate commercial transactions, particularly in international commerce, by assuring certainty in application, consistency in interpretation across jurisdictional boundaries, and swiftness in execution."), *vacated on other grounds*, 488 U.S. 920 (1988); *Sound of Market Street, Inc.* v. *Continental Bank Int'l*, 819 F.2d 384, 388 (3d Cir. 1987) ("Letters of credit serve international commerce by providing assurance of prompt payment at minimal cost.").

In addition to these "commercial" letters of credit, so-called "standby" letters of credit function as an efficient method of allocating the risks of non-performance of a wide variety of commercial and financial contractual obligations, including corporate and municipal bonds. *See* John F. Dolan, THE LAW OF LETTERS OF CREDIT ¶ 1.06 at 1-22 (2d ed. 1991) ("There are virtually no limits to the variety of transactions that the standby credit can serve."). Standby letters of credit provide security for the discharge of contractual obligations by placing in the promisee's hands a swift means of obtaining compensation for any defects in performance.

B. Interference With Letters of Credit By Bankruptcy Courts Would Threaten Their Viability.

Numerous courts have long recognized that the "essence of a letter of credit is the promise by a bank, or other issuer, to pay money," and that the "key to the uniqueness of a letter of credit and to its commercial vitality is that the promise by the issuer is independent of any underlying contracts." *Pringle-Associated Mortgage Corp.* v. *Southern Nat. Bank*, 571 F.2d 871, 874 (5th Cir. 1978); *see also Itek Corp.* v. *First Nat. Bank of Boston*, 730 F.2d 19, 24 (1st Cir. 1984) ("The very object of a letter of credit is to provide a near foolproof method of placing money in its beneficiary's hands. . . ."); *Rockwell Int'l Sys., Inc.* v. *Citibank, N.A.*, 719 F.2d 583, 587 (2d Cir. 1983); *United Technologies Corp.* v. *Citibank, N.A.*, 469 F. Supp. 473, 477 (S.D.N.Y. 1979) (bank's obligation on letter of credit is independent of its customer's obligation in underlying transaction). As the Second Circuit observed in *Rockwell*:

> "The letters of credit represent separate contractual undertakings that are, in legal contemplation, wholly distinct from whatever performance they ultimately secure. This is not merely an analytical nicety; the 'independence' principle is an example of legal form following commercial function, and it is recognized in domestic as well as international law."

719 F.2d at 587.

Courts thus have uniformly upheld the "independence principle," holding that, as a matter of law, the obligations of an issuing bank are totally independent of the underlying transaction. *See, e.g., Itek Corp.*, 730 F.2d at 24; *KMW Int'l* v. *Chase Manhattan Bank, N.A.*, 606 F.2d 10, 15-16

(2d Cir. 1979) ("As a matter of law, a bank's obligation under a letter of credit is totally independent of the underlying transaction."); *Pringle-Associated Mortgage Corp.*, 571 F.2d at 874 ("the uniqueness of a letter of credit . . . is that the promise by the issuer is independent of any underlying contracts"); *Chase Manhattan Bank* v. *Equibank*, 550 F.2d 882, 886 (3d Cir. 1977) ("[t]he beneficiary bases his claim on the letter of credit . . . not on the agreement between the customer and the issuing banks, nor upon the underlying arrangement between customer and beneficiary").

The independence principle allows parties to commercial transactions to rely on the "automaticity and brevity" of payment of a letter of credit in their decisions as to the risks and, thus, the price of transactions. Becker, *Standby Letters of Credit and the Iranian Cases: Will the Independence of the Credit Survive?*, 13 U.C.C.L.J. 335, 339 (1981) (discussing development of letters of credit and impact of threats to independence principle). *See also, e.g., American Bell Int'l, Inc.* v. *Islamic Republic of Iran*, 474 F. Supp. 420, 426 (S.D.N.Y. 1979) (bank would suffer loss of credibility from failure to pay letter of credit). Essential to that reliance is the parties' understanding that there will be minimal, if any, judicial interference with the issuing bank's payment on receipt of a demand in conformity with the terms of the credit. Without that assurance, the beneficiary has no certainty of payment, and the account party is unlikely to obtain what it needs at an acceptable price, if at all.

As the Supreme Court of Connecticut stated,

> "[O]ne of the expected advantages and essential purposes of a letter of credit is that the beneficiary will be able to rely on assured, prompt payment from a solvent party; necessarily, a part of this expectation of ready payment is that there will be a

> minimum of litigation and judicial interference, and this is one of the reasons for the value of the letter of credit device in financial transactions."

New York Life Ins. Co. v. *Hartford Nat. Bank & Trust Co.*, 378 A.2d 562, 566 (1977); *see also Frey & Son, Inc.* v. *E.R. Sherburne Co.*, 193 A.D. 849, 854, 184 N.Y.S. 661, 664 (1920) (it "would be a calamity to the business world" if injunctions against payment of letters of credit were regularly granted).

For these reasons, reversal of the decision of the Fifth Circuit could seriously impair the viability of letters of credit, and thus destabilize the vast number of transactions that depend on them: "Let there be no doubt. If they set about to do it, courts exercising bankruptcy jurisdiction can doom the credit as a commercial product and can doom it with the infrequent case. The mere threat of an injunction is sufficient to destroy the effectiveness of the credit." THE LAW OF LETTERS OF CREDIT, *supra*, ¶ 7.03[3][d] at S7-10 (supp. 1994).

Conclusion

By recognizing the independence of the obligation to make payments under a supersedeas bond or letter of credit from any rights or obligations of a debtor in possession in bankruptcy, the Court below reaffirmed a principle essential to vast numbers of commercial and financial transactions. For this reason, and the reasons stated herein, The New

York Clearing House Association urges that this Court affirm the judgment of the Court of Appeals for the Fifth Circuit.

Respectfully submitted,

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